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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. [redacted]30

LOUIS LOBER, CHARLES LOBER and ALMA T. LOBER, as Executors of the Last Will and Testament of Morris Lober, Deceased,
Petitioners,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR PETITIONERS

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Supreme Court of the United States

OCTOBER TERM, 1953

No. 606

LOUIS LOEBL, CHARLES LOEBL AND ALMA T. LOEBL, as Executors of the Last Will and Testament of Morris Loebl, Deceased,

Petitioners,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR PETITIONERS

Opinions Below

The opinion of the Court of Claims (R. 29-35) is reported in 106 F. Supp. 731. The dissenting opinion of Chief Judge Jones (R. 32-33) is also reported therein.

Jurisdiction

The jurisdiction of this Court rests upon 28 U. S. C. Section 1255(1). The judgment of the Court of Claims was entered on December 2, 1952 (R. 36). A motion for rehearing, filed by petitioners on December 31, 1952, was overruled on February 3, 1953 (R. 36). The time for filing

petition for writ of certiorari, under 28 U. S. C. Section 2101(c), was thereby extended until ninety days after February 5, 1968. *Mores v. United States*, 390 U. S. 161. The petition for writ of certiorari was filed April 1, 1968, and was granted on June 3, 1968 (R. 37).

Question Presented

Where a decedent creates a trust, under which any accumulated income is to be paid to the income beneficiary at his majority and the principal is to be paid to said beneficiary at age twenty-five, and said beneficiary has a vested interest in said income and principal which would descend to his heirs if he died before receiving the same, does a reserved power, possessed by the decedent at the time of his death, to accumulate income during minority and to pay the principal to said beneficiary before he is twenty-five, bring the principal of the trust within the decedent's gross estate, for Federal estate tax purposes?

Statutory Provisions Involved

Internal Revenue Code:

Sec. 811. Gross Estate.

> "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States * * *
>
> * * * *
>
> (d) *Revocable Transfers.*
>
> * * * *
>
> (2) *Transfers on or prior to June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or

In conjunction with any person, in other capacity, or revokable, or when the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, the property of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is inconsistent under this paragraph.

(26 U. S. C. 1942 ed. Sec. 811.)

Statement

The facts pertaining to the question presented here, as set forth in the stipulation of facts (R. 36-39) and as found by the Court of Claims (R. 24-26), may be summarized as follows:

Morris Leber, the decedent, died a resident of the State of New York on December 15, 1942. In 1924 and 1929 he had created essentially identical trusts for each of his three children (R. 5, 9, 12). The principal of each respective trust was to be paid over to the child when he reached the age of twenty-five. The decedent, who was the trustee of each of the trusts, had the discretion to accumulate income during the minority of the child, which accumulated income was to be paid to the child upon his attaining majority. The child was the sole designated beneficiary of the income and principal, with no alternative remainderman provided in the event of his death before the age of twenty-five. The decedent, as trustee, had the power to make distributions of principal to the beneficiary, the amount and time of such distributions resting in his discretion. There was no spendthrift provision in any of the trust instruments (R. 5, 9, 12).

The United States asserted a deficiency of estate tax, the part thereof involved in this proceeding being on the ground that the principal of said trusts was includible in the taxable estate (R. 34). On February 20, 1947, the petitioners, as executors, paid said deficiency, with interest (R. 34).

On April 22, 1947, a claim for refund was duly filed in the amount of $[illegible], with interest thereon of $[illegible], representing the portion of said deficiency that is involved in this proceeding, which was rejected in its entirety by the Commissioner of Internal Revenue (R. 26).

The Court of Claims held that said trusts were includible in the taxable estate, under Section 811(d)(2) of the Internal Revenue Code, on the authority of *Commissioner* v. *Holmes*, 326 U. S. 480 (R. 28-32).

Specifications of Error to be Urged

The court below erred:

1. In holding that the power reserved by the decedent, to accelerate distribution to beneficiaries with indefeasibly vested interests, subjects the trusts to estate tax.

2. In not holding that Section 811(d)(2) of the Internal Revenue Code is not applicable to such a power.

Summary of Argument

Each beneficiary had an indefeasibly vested interest in the principal and income of the trust for his benefit, which would go to his heirs, legatees or assigns in the event of his death before the age of twenty-five. Such interest was not subject to defeasance in favor of alternative takers, or reversion to the grantor, in the event of premature death. There was no such defeating condition which the decedent, by the exercise of the power, could remove by accelerated distribution.

There were no conditional interests in the beneficiary which the decedent could materialize by the exercise of any power or any alternative takers with an expectancy which the decedent could cut off by such exercise of any power, as was the case in *Commissioner* v. *Holmes*, *supra*. The decedent's power was not a substantive power to terminate

contingencies upon which the right of enjoyment was vested. The power was only as to the time of enjoyment. It could not have created or terminated any right of enjoyment of the property or changed the person or persons who were entitled to it.

In the *Holmes* case and every other case involving this question, with the exception of *Hays' Estate* v. *Commissioner*, 148 F. 2d 109 (CCA 6), the power to accelerate distribution was a power to remove a condition upon which the beneficiary's interest was based, and it was this substantive character of the power which was the sole basis for the imposition of the estate tax.

In *Hays' Estate* v. *Commissioner*, *supra*, the only case involving a power to accelerate distribution of unconditionally vested interests, the principle of the *Holmes* case was held not to be applicable, because the decedent did not have such a power to create or terminate any interest.

In *Theopold* v. *United States*, 164 F. 2d 404 (CCA 1), in which the beneficiaries also had unconditionally vested remainders, and the decedent reserved the power to make certain amendments, the *Holmes* case, likewise, was held inapplicable because the reserved power was not one under which the decedent could legally alter beneficial interests in the trusts, either directly or indirectly.

Section 811(d) has been applied consistently only to powers which reasonably might be deemed to constitute a substitute for testamentary disposition. In the instant case, the estate of any beneficiary who died prematurely would be subject to estate tax with respect to the undistributed principal and income of his trust, because of his ownership therein. If his interest were dependent upon the exercise or non-exercise of a power of the decedent, he would not have the ownership requisite for estate taxation. The power of the decedent cannot be deemed a substitute for testamentary disposition with respect to property over which the beneficiary has such a fundamental and independent ownership.

The creation of a trust under which the reserved power is only with respect to the time of distribution, constitutes a taxable gift. As such a power is sufficient to render the gift incomplete, it is likewise insufficient for estate taxation under Section 811(d).

The failure to distinguish between conditional interests, such as those in the *Sanford* case, and the unconditionally vested interests in the instant case, would produce the extraordinary result of making Section 811(d) applicable to gifts by a grantor to an infant child, with himself as guardian for such child—since the child has vested ownership subject only to determent of possession, and the guardian has discretionary power with respect to the distribution of income and principal.

Argument

The court below held that Section 811(d) was applicable to the power held by the decedent, upon the authority of the decision of this Court in *Commissioner v. Holmes*, *supra*. It predicated its position upon the following statement in this Court's opinion in that case, which it deemed "conclusive of the instant case" (R. 31):

> "It seems obvious that one who has the power to terminate contingencies upon which the right of enjoyment is staked, so as to make certain that a beneficiary will have it who may never come into it if the power is not exercised, has power which affects not only the time of enjoyment but also the person or persons who may enjoy the donations. More therefore is involved than mere acceleration of the time of enjoyment. The very right of enjoyment is affected, the difference dependent upon the grantor's power being between present substantial benefit and the mere prospect or possibility, even the probability, that one may have it at some uncertain future time or perhaps not at all. A donor who keeps so strong a hold over the actual and immediate enjoyment of what he puts beyond his own power to retake has not divested himself of that degree of control which Section 811(d)(2) requires in order to avoid the tax."

In the Holmes case, the decedent created a fifteen year trust for each of his three sons. In the event of the death of a son before the expiration of fifteen years, the principal of his trust was to go to his issue by testamentary disposition, in the other case of their issue. The trustee reserved the power to distribute or accumulate income and the power to terminate any of the trusts, in which event the principal was to go to the beneficiary entitled to the income.

Obviously, the interests of the sons in the trusts were not indefeasibly vested, as the income might or might not be distributed by the trustee during the duration of the trusts. The power of the decedent to terminate was a power to give the principal which otherwise would go to other remaindermen, as provided in the trust instrument, to the sons that during the duration of the trusts. On the other hand, by the non-exercise of the power to terminate or by the exercise of the power to accumulate income, the decedent could give the principal or income to the alternative remaindermen in the event of the primary beneficiary's premature death. In effect, the [illegible] interests of the beneficiaries were contingent, and could not be said to constitute property rights vested in the decedent. Since only the power to accumulate income was exercised by the trustee in favor of the sons, the Supreme Court held that there was a qualitative provision which prevented the tax from attempting to assign even the [illegible]

The language in the Holmes case [illegible] a vested interest existed only to the extent to which the Court rejected such arguments as to the [illegible] cal fiction whether the sons' interests were subject to a condition subsequent or condition precedent and obviously based its decision upon the substantive reality that the decedent could, by the exercise of the power, confer an economic benefit on the beneficiary at the expense of someone else who might otherwise take. The decedent had the

power at this death, by eliminating defeating contingencies, to consummate economic rights in one beneficiary adversely to other beneficiaries who otherwise would benefit from the nonoccurrence of the defeating event. To that extent it was a power to create a right of enjoyment in one beneficiary and to terminate correlative rights in other beneficiaries.

We cannot see how the foregoing statement by this Court in the *Holmes* case, upon which the court below based its decision, can be regarded as "conclusive of the instant case," except by some inexplicable process of inversion. It is submitted that the statement, even literally, but especially when read in its factual context, is clearly antithetical in its meaning to the one ascribed to it by the court below. In the first place, it refers to "the power to terminate contingencies on which the right of enjoyment is staked." The "right" of enjoyment of the beneficiaries in the instant case was not based upon any contingencies as was the fact in the *Holmes* case. They had all of the rights of ownership of principal and income, subject only to the deferment of possession. They were in no different position than an infant or incompetent, the possession of whose property was in the hands of a guardian or committee. Subject to the deferment of possession, they could pass on their unconditionally vested interests to their heirs, legatees or intestates; and they could, in effect, consume said interests by incurring indebtedness to which they would be subject upon their death. Because the ownership of said interests was independently, in them, immune from impairment or enlargement by any power of the decedent, said interests would be subject to estate tax in the event of the death of any beneficiary before the termination of his trust; *Kinney's Estate v. Commissioner*, 30 F. 2nd 650 (CCA 9); *Estate of John S. Fraser v. Commissioner*, 168 F. 2d 167 (CCA 5), but would not be so subject to estate tax if their interests had been conditional, as in the *Holmes* case. *Commissioner v. Hesser*, 64 F. 2d 621 (CCA 3).

In the second place, this Court, in the above passage, said: "More therefore is involved than mere acceleration

of the time of enjoyment." The only reasonable meaning this could have is that the result would have been different if only acceleration, as contrasted with the right of enjoyment, had been involved. This Court seemed to have no doubt about this by stressing, in the next sentence, that "the very right of enjoyment is affected. * * *"

The lower court's assimilation of the instant case with the *Holmes* case disregards the factual realities, as well as the different legal implications of the purpose and scope of Section 23(t)(1). In the *Holmes* case, the decedent did not, as in the *Holmes* case, have the power to defy economic interests between beneficiaries with conditional interests, either by materializing the expectancy of one beneficiary by eliminating the defeating condition as to him, at the expense of the other beneficiary, or by preserving the expectancy of the latter, at the expense of the former. A failure to recognize this basic factual difference would render meaningless the reasoning of this Court in the *Holmes* case, as is readily seen in the lower court's application of the following conclusion drawn therefrom by it to the facts in the instant case:

> * * * As the Supreme Court said, it was not a mere question of acceleration of payment, of whether he should enjoy the property sooner or later, but whether he should enjoy it at all, or not. * * * (R. 31)

By this interpretation—with no discrimination between conditional and unconditional interests—any grantor who had the power merely to accelerate payment would automatically have the power over "whether he should enjoy it at all, or not"—because, by such synonymy of enjoyment and possession, any beneficiary of any trust will not enjoy it at all if he dies before distribution, regardless of whether he has an unconditionally vested or contingent interest. Thus, if "enjoyment" is used solely in the sense of possession by the beneficiary, as the court below has obviously used it, then, *in all cases*, the power merely to accelerate payment is necessarily the same as the power to confer the right of enjoyment.

The court below, in effect, says that any power to give any beneficiary possession before his possible death is subject to Section 811(d). As every beneficiary is subject to the possibility of death at any time, any power to accelerate the time of enjoyment would be taxable. But what this Court said in the *Holmes* case was that "More therefore is involved than mere acceleration of the time of enjoyment"—that "The very right of enjoyment is affected. * * *."

If Section 811(d) were applicable to every power to accelerate the time of enjoyment, then the distinction drawn and stressed throughout the opinion of this Court in the *Holmes* case, between a power merely to accelerate the *time* of enjoyment and a power over the *right* of enjoyment, would be meaningless and unnecessary.

The Court of Appeals for the 6th Circuit did not regard this distinction as meaningless, in *Hoge's Estate v. Commissioner*, *supra*, the only decided case, other than the instant one, involving a power to accelerate distribution to beneficiaries with unconditionally vested remainders. In that case, in which the decedent reserved the power to accumulate income and to terminate the trust at any time, the trust instrument provided that in the event of the death of any of the beneficiaries his interest "shall pass to his or her heirs at law under the laws of descent and distribution of the State of Mississippi." In that case, with which the court below in the instant case does not agree, the Court of Appeals recognized that the decision in the *Holmes* case turned on this very point—to be taxable the power has to be over the right of enjoyment rather than the mere acceleration of the time of enjoyment. The Court there said:

> "The exercise of the power of the decedent to terminate the trust could not have created or terminated any right of enjoyment of trust property or changed the person or persons who were entitled to enjoy it."

The beneficiaries in the *Hoge* case had exactly the same interests in the principal and income as the beneficiaries in

the instant case had under New York law. The Court of Appeals, in a footnote, pointed out that this also would have been the case under Mississippi law in the absence of words of inheritance in the trust instrument. The court below in the instant case accepted but did not decide that the beneficiaries had unconditionally vested interests (R. 31). It is established beyond any doubt under New York law, which is controlling as to the character of the beneficiaries' interests, *Helvering v. Stuart*, 317 U. S. 154; *Blair v. Commissioner*, 300 U. S. 5, that the beneficiaries had unconditionally vested interests in the present. *Manufacturers Trust Company v. Chase National Bank*, 282 N. Y. 120; *Cammann v. Bailey*, 240 N. Y. 29; *Connolly v. O'Brien*, 166 N. Y. 406, and in any income accumulated during minority, *Smith v. Parsons*, 146 N. Y. 116; *Morris v. Morris*, 272 N. Y. 181.

In every decision by a Court of Appeals or by the Tax Court of the United States touching this question since the decision of this Court in the *Holmes* case, said decision by this Court has been interpreted as meaning that Section 811(d) is applicable only to powers over conditional interests. The following are some of those decisions:

Hays' Estate v. Commissioner, supra.

"His power under the trust instrument *affected* not only the time of possession and enjoyment but also the person or persons who might come into ownership and enjoyment of the property. The reservation of power to shift or vary in that manner the interests of the beneficiaries was a substantial abridgment of ownership and control." (Italics supplied.)

Loughridge's Estate v. Commissioner, 183 F. 2d 294 (CCA 10) cert. den. 340 U. S. 830 (at page 300).

"Each son's enjoyment of the remainder was uncertain in that it depended on his surviving until the termination of the trust. The settlor's reserved power of termination was thus a power whereby the

...ability could at any time not only accelerate the time of enjoyment, but could transform an otherwise uncertain expectancy of enjoyment into a certainty." (Italics supplied.)

Hamilton's Estate v. Kelly, 195 F. 2d 248 (CCA 2) (at page 251).

"Under Reg. 111 (f) the fact that the decedent was only a remote donee of a limited class is immaterial. Commissioner v. Estate of Holmes, 1948, 326 U. S. 480, 66 S. Ct. 278, 90 L. Ed. [illegible]. But under that rule only the interest that may be shifted is considered in the gross estate." (Italics supplied.)

Industrial Trust Co. v. Commissioner, 165 F. 2d 728 (CCA 1) (at page 730).

"The test is not whether the change has to be brought about by an acceleration of the falling in date of possession or in some other particular way but whether the power reserved may be exercised to shift economically substantial economic benefits." (Italics supplied.)

Commissioner v. Holmes's Estate, 149 F. 2d 798 (CCA 1) (at page 805).

"The power reserved to the trustees by this indenture is a power similar to that given in the *Holmes* case, supra, of which the Supreme Court said that one who has a power to terminate contingencies upon which the right of enjoyment is shifted, so as to make certain the enjoyment by those [illegible] who may never come into it if the power is not exercised, has a power which affects not only the time of enjoyment but one which is determinative of the persons who may enjoy the trust estate, a power which affects the very right to enjoyment itself." (Italics supplied.)

Zinjacke v. Seofield, 137 F. 2d 685 (CCA 5) (at page 690).

See also

Estate of Frank Clowe, 17 T. C. 1467 (at page 1472).

In *Theopold* v. *United States*, *supra*, the decedent had created a trust for his three infant children. He reserved the power to amend the trust instrument so that "it will more clearly express my intentions." The trust instrument provided that if a child over 21 died, the share from which he was receiving income was to be paid over to his executor or administrator. Pursuant to his power to amend, the decedent amended this provision by giving his children a testamentary power of appointment, with provision for alternative distribution in default of exercise of the power. The Court held that, while this was more than a mere clarifying amendment, it was not a substantive change and was not indicative of an intention by the decedent to reserve the kind of a power that would subject the trust to estate tax. The Court based its entire inquiry in that case upon the premise that this Court has established the principle that only powers to alter substantive or beneficial interests give rise to tax.

> "Since we construe the power not as one under which the decedent up to the time of his death could legally alter beneficial interests in the trust, either directly as in Porter v. Commissioner, 288 U. S. 436, 53 S. Ct. 451, 77 L. Ed. 880, or in practical effect as in Commissioner v. Estate of Holmes, 326 U. S. 480, 66 S. Ct. 257, 90 L. Ed. 228.
>
> "The judgment of the District Court is reversed and the case is remanded to that court for the entry of a judgment for the plaintiff."

No case has been found in which there is even any dictum to the effect that the decision in the *Holmes* case is applicable to a power to distribute an interest to one unconditionally vested therewith. The decision of the court below in the instant case stands alone against a uniformly contradictory judicial background.

Furthermore, the decision of the court below is in conflict with the basic principle established by this Court in the early cases involving Section 811(d), such as *Porter* v. *Commissioner*, 288 U. S. 436, and *Estate of Sanford* v.

Commissioner, 306 U. S. 39. In the *Porter* case, this Court made it clear that only substantive powers are covered by Section 811(d), that is to say, powers whose termination by death constitutes a substitute for testamentary disposition.

> "His death terminated that control, ended the possibility of any change by him and was, in respect of title to the property in question, the occasion of valuable interests passing from the dead to the living. That is the event on which Congress based the inclusion of property so transferred in the gross estate as a step in the calculation to ascertain the amount of what in section 301 (26 USCA Secs. 1092, 1093) is called the net estate. Thus was reached *what it reasonably might deem a substitute for testamentary disposition.*" (Italics supplied.)

The assimilation of the instant case with the *Holmes* case is in conflict with the purposes of Section 811(d) and the rationale for its application which consistently run through the cases from the beginning. The underlying purpose of the estate tax provisions which impose estate tax upon the subject matter of certain lifetime transfers, is to prevent avoidance of estate tax by transfers which are essentially substitutes for testamentary disposition. *Porter v. Commissioner, supra; Helvering v. City Bank Farmers Trust Company*, 296 U. S. 85; *Estate of Sanford v. Commissioner, supra; Helvering v. Hallock*, 309 U. S. 106.

This basic legislative purpose was reaffirmed by this Court, as follows, in *Commissioner of Internal Revenue v. Church*, 335 U. S. 632 (at page 643):

> "We declared that the statute now under consideration 'taxes not merely those interests which are deemed to pass at death according to refined technicalities of the law of property. It also taxes inter vivos transfers that are too much akin to testamentary dispositions not to be subjected to the same excise,' p. 112, and inter vivos gifts 'resorted to, as a substitute for a will, in making dispositions of property operative at death,' p. 114."

The decision in the *Holmes* case may be said to be merely an application of the basic principle, established in the foregoing cases, to a power of disposition between different conditional beneficiaries of the decedent's own designation. In the instant case, neither the creation of the trusts nor the expiration of the power upon the decedent's death can in any sense be viewed as "substitutes for testamentary disposition." The persons who would take from the beneficiary, if he died before distribution, would be persons beyond the designation or control of the decedent. No individual or class of persons was designated by the decedent to receive the income or principal in the event that the named beneficiary died before receiving the same. The right to designate that person or class of persons, or any other recipient, rested exclusively with the beneficiary. In the event that the beneficiary did not exercise that right, by either inter-vivos or testamentary disposition, the recipients would be determined by the applicable laws of descent—not by the decedent. How can it be cogently urged that the decedent could make any choice between the named beneficiary and said beneficiary's heirs when the latter are still carried within the beneficiary during his lifetime?

The equitable ownership to all of the trust property was vested in the named beneficiary and his heirs. It is clear that no retained control of the decedent could "alter, amend or revoke" that ownership. That is far different from the power of the decedent in the *Holmes* case, by exercise thereof, to consummate otherwise conditional rights in the primary beneficiaries of his own selection and thereby to cut off completely the interests of alternative remaindermen also of his own selection or, by non-exercise thereof, to maintain the interests of said alternative beneficiaries.

The "right of enjoyment" which the decedent had the power to confer in the *Holmes* case was more than immediate possession. It was the right to economic ownership. In the *Holmes* case, the Government itself recognized

and urged this fundamental aspect. In its brief, in that case, [illegible] page 17:

> "The above-described subjection of the beneficial interests in the trust to the decedent's powers to control or eliminate their enjoyment can hardly be described, with any accuracy, as a subjection of those interests to a mere power to accelerate enjoyment. . . ."

The decision of the court below in the instant case is a variance from all of the other cases, which is neither required nor supported in principle, nor by any practical considerations. It is an unprecedented and extended application of Section 811(d), with serious and unjustified potential tax consequences. The decedent-grantor of such a trust would be subject to estate tax because of his supposed power over the property, and the beneficiary of the trust, in the event of his death before distribution, would himself be subject to the estate tax with respect to the same property, because of his ownership of the principal and income interests therein. *Kenner's Estate v. Commissioner, supra.* It is readily apparent that the taxation of the beneficiary because he owns the interest in the trust is completely inconsistent with any power of the decedent to create or effect said ownership. If the beneficiary's interests were dependent upon the exercise or non-exercise of a power by the decedent, he would not have the ownership requisite for estate taxation. *Commissioner v. Kenner, supra.* But he clearly does have such ownership.

Despite such ownership by the beneficiary, there would be a tax upon the grantor-decedent on the theory that because of his retained powers his death effected a disposition in the nature of a substitute for a testamentary disposition, and another tax on the beneficiary because he had a vested interest which he received when the trust was created. This would be a perversion of the tax avoidance purpose of Section 811(d) into a special levy upon those unwary persons who created such trusts in bygone years without the slight-

ent semblance of any tax avoidance motives, and, also, we might add, without the slightest reason to suspect that the fund they were so providently providing for the future of their children might suffer the improvidence of such tax invasion.

Furthermore, no matter where or how one tries to articulate the decision of the Court below in the instant case with the body of developed tax law it is a square peg in a round hole. Section 811(c) of the gift tax regulations (Appendix) provides that "a gift in trust is incomplete if the donor reserves the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves," but provides, contrariwise, that "a gift shall not be considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment thereof." It is submitted that, if the reserved powers are not sufficient to render the gift incomplete, they are likewise insufficient for estate taxation under Section 811(d).

While this Court, in *Smith v. Shaughnessy*, 318 U. S. 176, and *Helvering v. Helvering*, 316 U. S. 106, pointed out that it was not intended in *Estate of Sanford v. Commissioner*, 308 U. S. 39, to establish a general principle that gift and estate taxes are "always" mutually exclusive, it did not question the correct conclusiveness of such cases as the *Sanford* case, which involved Section 811(d) powers. This Court merely refused to extend such conclusiveness to cases involving interests reserved to the grantor, such as reversion interests and reserved life estates, as contrasted with the reserved powers in the *Sanford* case. That it did not intend to allow the applicability and conclusiveness of the *Sanford* decision in cases involving reserved powers, seems evident from the following statement in the opinion in the *Shaughnessy* case, at p. 181:

> "The separable interests transferred are not gifts to the extent that power remains to revoke the trust or recapture the property represented by any of them, Burnet *v.* Guggenheim, supra, or to modify the

terms of the arrangement *so as to make other disposition of the property.* Sanford *v.* Commissioner of Internal Revenue, *supra.* In the Sanford case the grantor could, by modification of the trust, extinguish the donee's interest at any instant he chose. In cases such as this, where the grantor has neither the form nor substance of control and never will have unless he outlives his wife, we must conclude that he has lost all 'economic control' and that the gift is complete except for the value of his reversionary interest." (Italics supplied.)

It also alluded as follows, at page 179 of the same case, to the fact that Congress intended some gifts to be subject to estate tax and "some not."

> "It is sufficient to note here that Congress plainly pointed out that 'some' of the 'total gifts subject to gift taxes . . . may be included for estate tax purposes *and some not.*' House Report No. 708, 72d Cong. 1st Sess., p. 45." (Italics supplied.)

It seems clear that trusts involving the question of Section 811(d) powers are an exception to the general principle that gift and estate taxes are not always mutually exclusive. No other type of transfer would seem to have any better reason to stand in that position. Accordingly, in view of the fact that the reserved powers in the instant case would not render the gift incomplete, they should not serve as the basis for estate tax.

The said test of whether a transfer is subject to estate tax is whether or not the gift is incomplete until the donor's death. *Helvering* v. *Hallock*, *supra*, in which this Court said the following, at pages 113 and 114:

> "By bringing into the gross estate at his death that which the settlor gave contingently upon it, this Court fastened on the vital factor. * * *
>
> * * *
>
> 'However we label the device it is but a means by which the gift is rendered incomplete until the donor's death.'"

In the instant case, the gifts were complete when made. The beneficiaries in any event had the indefeasible right to receive all of the principal and all of any accumulated income at twenty-five or, if they died before attaining that age, their assigns or estates would, through them, receive said principal and income, if they had not already been consumed by debts incurred by the beneficiaries. And that also would have been the case if the decedent had not reserved the power to accelerate distribution. These gifts of all of the principal and income were complete when the transfers were made and were not "rendered incomplete until the donor's death." The gifts were not rendered incomplete by any reserved enjoyment by the decedent, as in the *Church* case, nor by any reserved power, as in the *Holmes* case, to divert them to anyone other than those in whom they were fixed by the transfers.

The power of the decedent, in the instant case, could not serve to withhold from the beneficiaries that which already was theirs from the beginning by virtue of the transfers. Certainly, if the power had been absent, there could be no question that the gifts were complete when made. How, then, could the same gifts, complete without the power, be rendered incomplete by a power that could not hamt or restrict them in any way? The gifts, with or without the power to accelerate, were equally complete at the time of the transfers and nothing passed from the deed to the living at the time of the grantor's death, within the contemplation of any of the estate tax provisions having to do with inter-vivos transfers. *Shukert* v. *Allen*, 273 U. S. 547. See Regulations 105, Sec. 81.17 (see Appendix) containing the following as an example of a transfer which is not subject to estate tax:

> "*Example (4).* The decedent, during his life, transferred property in trust, providing for payment of the income to his son until the latter reached the age of 25, at which time the son would receive the corpus. If the son died before reaching 25, the corpus was to revert to the decedent if living; and if not,

it was to pass to his son's heirs. His portion of the property is includible in the decedent's gross estate. Although the property may revert to the decedent, his son can obtain possession or enjoyment of the remainder interest even though the decedent is living. Thus, the first requirement is not satisfied."

Imposition of the estate tax in these two cases, where the beneficiaries take specifically vested interests, merely because of a power to accelerate that possession would require the blanketing under Section 811(d) of gifts by a grantor to an infant child with himself as guardian for the child. Section 811(d) covers any interest of which the decedent "has at any time made a transfer, by trust or otherwise, . . ." Such an infant, for whom the grantor acts as guardian, has vested ownership rights subject to deferment of possession of the principal, and the guardian has discretionary power with respect to distributions of income and principal. And such a guardian is subject to the same supervision as a trustee. If the line cannot be drawn short of the trusts in the instant case, then it is submitted that a grantor-guardian would likewise be subject to Section 811(d). Certainly, such a result could not have been within the presumed legislative intent.

In short, the decedent did not have a power to "alter, amend or revoke" under Section 811(d). To say that his power to make early distribution was such a power is an unrealistic as to say that a mortgagor who has a right to anticipate payments has reserved the power to alter, amend or revoke the debt created by him and owned by the mortgagee.

This case does not contain any of the aspects sought to be reached by the estate tax provisions as substitutes for testamentary dispositions. The transfers were not to take effect at death. The decedent did not reserve any enjoyment to himself, nor did he reserve any power of disposition among others.

It is respectfully submitted that the unprecedented application of Section 811(d) in the instant case is neither required by, nor finds support in, the *Helvering* case or other cases dealing with that section, and is contrary to the purpose of said section. Furthermore, in view of the penalising tax aspects, such a departure from or extension of the scope of Section 811(d), as heretofore applied, should not be adopted, in the absence of the mandate of a clearly expressed legislative intent or impelling practical considerations of the revenue, neither of which factors is present in this case.

Conclusion

The decision of the Court of Claims is incorrect and should be reversed.

Respectfully submitted,

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Appendix

Section 25.2(a) of Regulations 105:

"As to any property, or part thereof or interest therein, of which the donor so parted with dominion and control as to leave in him no power to change the disposition thereof, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over the disposition thereof, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power the terms of the power must be examined and its scope determined.

"A gift is incomplete in every instance where a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete where and to the extent that a reserved power gives the donor the right to name new beneficiaries or to change the interests of the beneficiaries as between themselves. Thus, the transfer of an estate for life, where, by an exercise of the power, the estate may be terminated or cut down to one of less value, is incomplete. A restriction upon the extent to which the power may be so cut down constitutes an incomplete gift. If in this example the power was unlimited as to the right to cut down the estate for life to one for a term of five years, the valuation of an estate for life or for more than that term results in a gift to that extent complete."

Section 81.17 of Regulations 105, as amended by T. D. 5512, 1946-1 Cum. Bull. 264:

"Sec. 81.17. *Transfers Intended to Take Effect At or After the Decedent's Death.* A transfer of an interest in property by the decedent during his life (other than a bona fide sale for an adequate and full consideration in money or money's worth) is 'intended to take effect in possession or enjoyment at or after his death,' and hence the value of such property interest is includible in his gross estate, if

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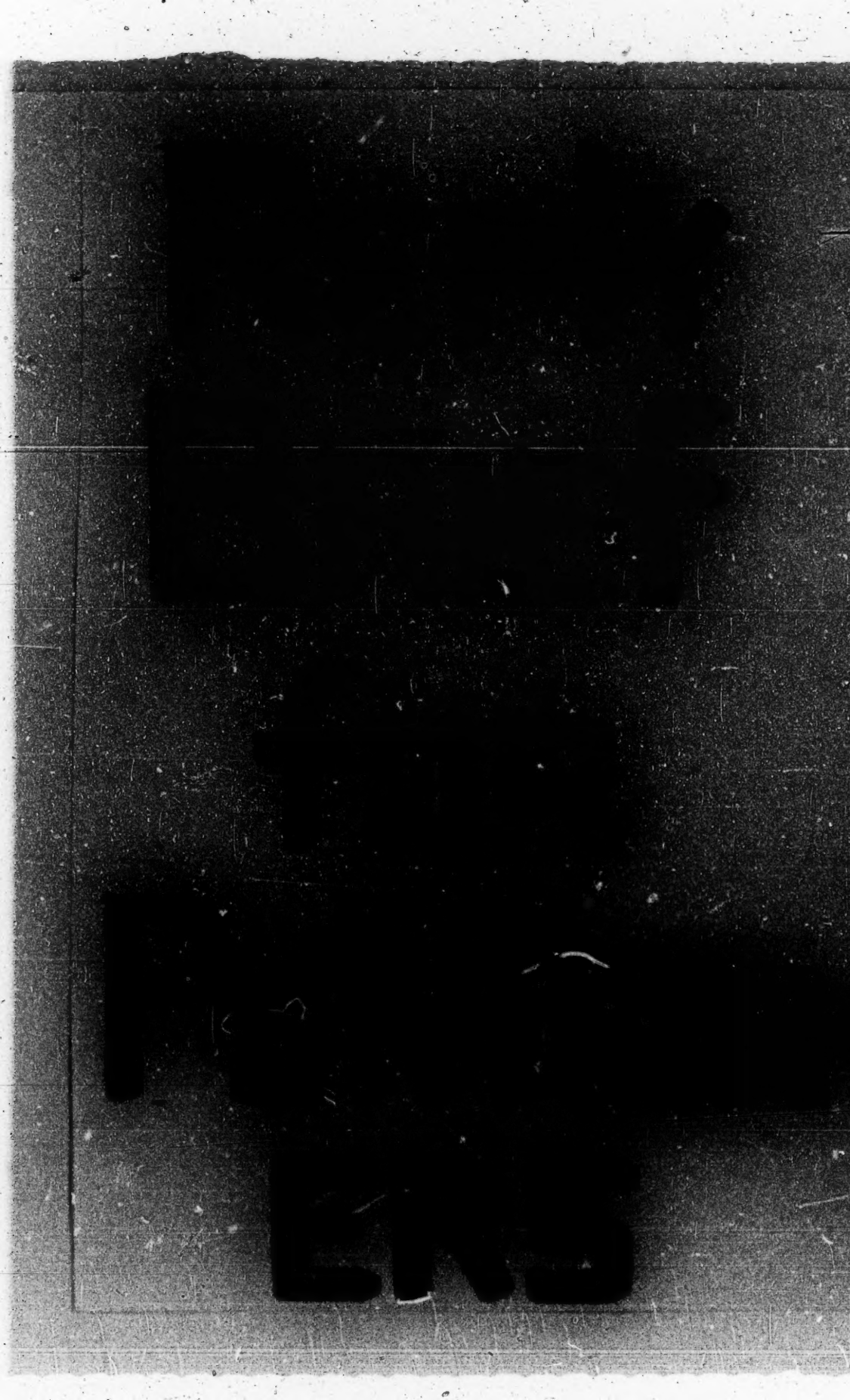

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. 30

LOUIS LOBER, CHARLES LOBER and ALMA T. LOBER, as Executors of the Last Will and Testament of Morris Lober, Deceased,
Petitioners,

v.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR PETITIONERS

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IN THE

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OCTOBER TERM, 1953

No. 30

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Petitioners,

v.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR PETITIONERS

The argument in this case was had before this Court on October 16, 1953. This reply brief is filed pursuant to permission to do so granted by the Court at the time of the argument.

The respondent in its brief contends (1) that, whether or not the interests of the beneficiaries were indefeasibly vested, the power reserved by the decedent was a power to change the enjoyment of the interests he had transferred, and (2) that in any event the interests of the beneficiaries were not vested, so that there is no basis for distinguishing the *Holmes* decision.

It is submitted that, on the first point, the respondent's brief is not responsive to the authorities set forth in the

petitioners' principal brief, and that, for the reasons set forth in the petitioners' principal brief and in this reply brief, the decedent did not have the power to change the enjoyment of the interests at the time of his death. On the second point, the respondent significantly avoids the abundant decisions in New York dealing directly with the dispositive pattern involved in the trusts in the instant case, and suggests a non-existent differentiation between *inter vivos* and testamentary trusts, on the basis of an irrelevant decision in another jurisdiction and the respondent's own construction of what the law of New York ought to be in the instant case.

I

The decedent did not have the power to change the enjoyment of the transferred interests, within the contemplation of Section 811(d).

In effect, it is the respondent's argument, throughout Point I of its brief, that even if the beneficiaries had indefeasibly vested interests, a power by the decedent to give them immediate possession, which possession they might not otherwise receive personally, was a power to change enjoyment. The word "enjoyment" is susceptible of such an interpretation only if it is isolated from the context of all other considerations having a vital bearing upon the case, namely, the background and purpose of Section 811(d); the fact that other means of effecting personal enjoyment were already available to the beneficiaries through assignment of their interests; and the fact that, at the time of the decedent's death, the beneficiaries were infants and anticipatory distributions by the decedent would, under New York law, have had to be made to their guardian—so that early distribution or termination by the decedent would not have given the beneficiaries the untrammeled possession required to constitute "enjoyment" under the respondent's own argument.

1. As pointed out on pages 13 to 15 of the petitioners' principal brief, this Court has consistently pointed out and stressed in a number of cases that only substantive powers are covered by Section 811(d), that is to say, powers whose termination by death constitutes a substitute for testamentary disposition. It would be sheer fantasy to suggest that the trusts in the instant case were conceived or intended as, or were in fact, substitutes for a testamentary disposition. In creating the trusts, the decedent may very well have been motivated by a desire to remove the completely donated property from his taxable estate, but he could not have had any notion of reserving to himself the freedom or power to redirect to other beneficiaries the course of the property given away or shift the interests between beneficiaries. Presumably, the provision for distribution at age 25, with a power to accelerate distribution, reflected uncertainty by the decedent that the beneficiaries would be sufficiently capable of receiving the property at 21, and the decedent desired to provide a four-year margin of safety in that regard. The possibility of the death of a beneficiary before age 25 during the decedent's lifetime was so remote as to furnish no rational basis for attributing to the decedent any possible motive to reserve a power akin to a testamentary disposition. If he desired to retain any substantive powers that could furnish anything remotely resembling a testamentary design, he would most certainly have adopted a much more comprehensive and effective means of doing so.

2. The respondent (Br. 19, 24) contends that the fact that the alternative takers, in the event of the death of the primary beneficiary, are specified by the New York Decedent Estate Law in the instant case and were designated in the trusts in the *Holmes* case makes no difference. It is submitted that the interpretation and administration of our tax laws has not become so tenuous as to warrant such a disregard of the legal and substantive realities as is tacit in such a conclusion. In the first place, one of the beneficiaries was capable of determining his own distributees by will (Br. 18), and those who would take by intestate

cooperation from the other beneficiaries would take through said beneficiaries and not from the decedent, and their liability was not subject to disposition or control by the decedent. The fact that the decedent, at his death, may have been one of the heirs of a beneficiary would not, as seems to be suggested in respondent's brief (Br. 19), establish a reversion to the decedent of such an intangible interest.

Estate of Oberlin D. Marshall, 19 T. C. 918, affirmed 203 F. (2d) 556.

3. There was a spendthrift provision in the trust in the *Holmes* case but none in the instant trusts. In the instant case, there was no restriction on the alienation by the beneficiaries of their remainder interests.

Section 15 *of New York Personal Property Law*;
In re Brand, 156 Misc. 312;
Commissioner v. Hall, 153 F. (2d) 173 (CCA 2).

As a matter of fact, the beneficiaries, even while infants, had the power, through the general guardian of their property, to effect an alienation of their remainder interests. Their vested interests constituted their own property and, as to such property, they could, being over the age of 14, have such a guardian appointed on their own petition. Section 178 of the *Surrogate's Court Act of New York*, which provides that a guardian of the property of an infant over 14 may be appointed solely on the infant's own petition, if he is of sound mind.

Accordingly, the beneficiaries, without the concurrence by the decedent of any power, could, through sale and assignment of their interests, have effected the equivalent of personal realization, which the respondent insists is "enjoyment". The fact that the consideration realized on any such sale would be held and administered by a guardian, would, as is pointed out below, be no different than the result of termination of a trust by the decedent, because

in the latter case the principal would also have to be turned over to a guardian for the infant.

Such an anticipatory realization by sale would unquestionably constitute enjoyment by the beneficiaries. It is well established that, for tax purposes, anticipatory realization of money or property, which is not payable or deliverable until some future date, by assignment of the right thereto for a consideration, constitutes enjoyment.

Lucas v. Earl, 281 U. S. 111;
Helvering v. Eubank, 311 U. S. 122;
Helvering v. Horst, 311 U. S. 112.

At this point, reference should be had to *Miller v. Driscoll*, 117 F. (2d) 477, so heavily relied on by the respondent (Br. 3, 18-20, 24). In that case, in which the decedent had the power to terminate the beneficiaries were given a testamentary power of appointment. They had no vested interests which they could realize (a fruition realization by assignment). The respondent (Br. 29) stressed the fact that in that case the beneficiaries did not have "a present right to use or invest or dispose of the property". Even in that case the Court of Appeals for the Third Circuit refused and held that "a shift of economic benefits has been accomplished" and clearly determined that the decedent could relinquish testamentary powers and had (at most) a power to alter enjoyment by a mental hesitancy. The same Court of Appeals in the later case of *Rossmiller's Estate v. Commissioner*, 156 F. (2d) 646, again said:

"But under Sec. 811(f) only the interest that may be enjoyed is included in the gross estate."

4. The respondent (Br. 28), apparently in ignorance of the New York law with respect to the administration of trusts in that respect, states:

"* * * As trustee, viewing the situation in practical terms, the decedent was free to turn over both income and accumulated principal for all the motor cars

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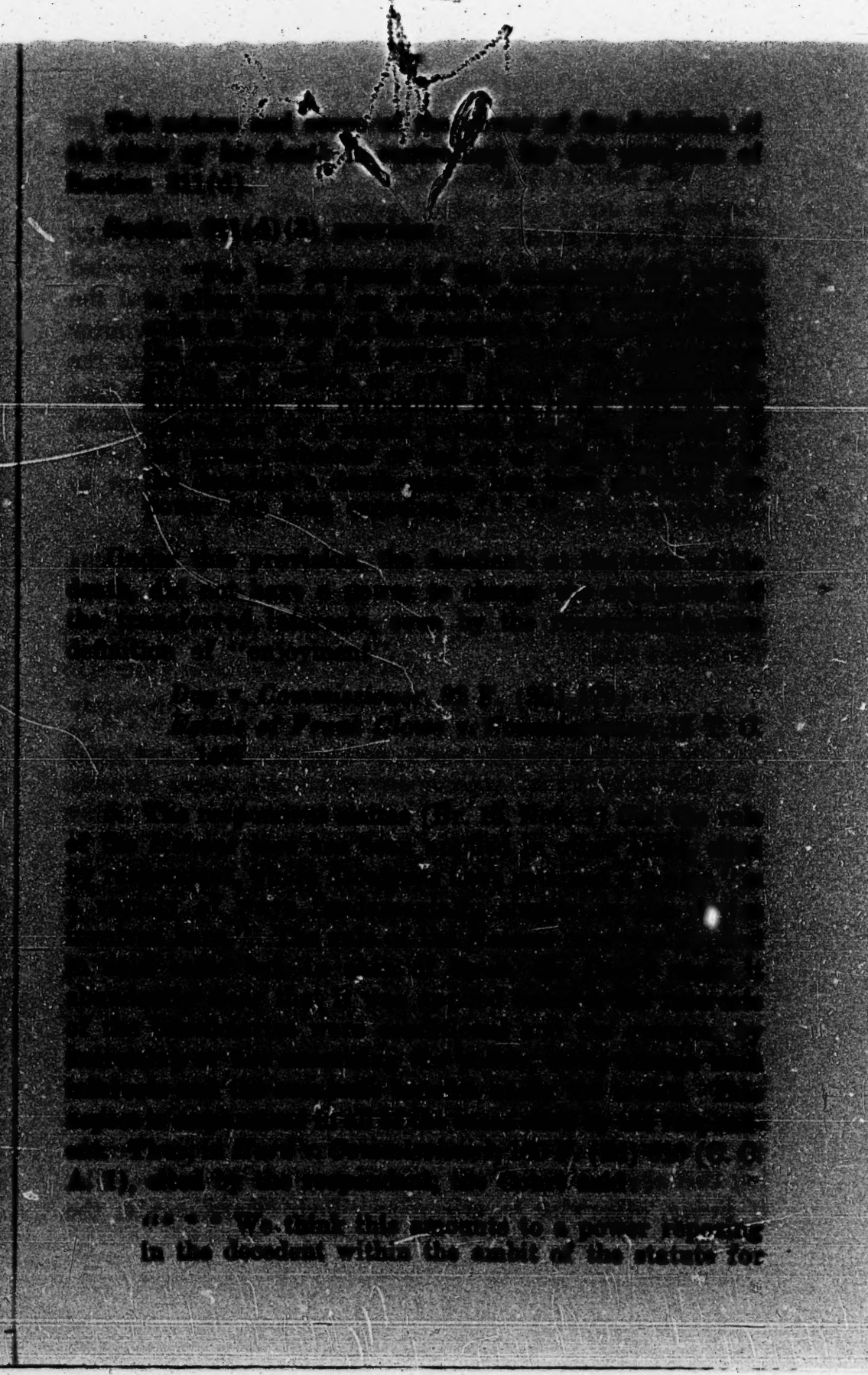

. . . We think this amounts to a power reposing in the decedent within the ambit of the statute for

> It is incompatible that he had the power to reduce or eliminate altogether the shares of the daughter's issue, heirs or appointees. * * *."

In *Sharp's Estate v. Commissioner*, 154 F. (2d) 966 (C. C. A. 3), cited by the respondent, the trust provided income to the children for life, and upon the death of the last child the principal was to go to the issue of the grantor living at the grantor had the power to terminate the trust upon the consent of the children. The court held that the children did not have an interest adverse to termination, because termination would give them the "absolute property" in the corpus, as compared to only the income to which they were otherwise entitled.

In *Commissioner v. Rossbold's Estate*, 156 F. (2d) 634 (C. C. A. 2), cited by the respondent, the interests of the beneficiaries in the income and principal were contingent. The Court said:

> "* * * If anything is clear from this rather obscurely drawn trust indenture, it is that 'No person * * * as a beneficiary shall have any absolute or vested right to receive from income any payments either directly or for his benefit * * *' (paragraph VI). Thus the exercise of the power to terminate would, depending on the time when it was exercised, *determine the beneficiaries among whom the income would be divided, and similarly as to corpus of the trust estate.* We think the case falls squarely within *Commissioner v. Estate of Holmes*, 326 U. S. 480, 66 S. Ct. 257." (Italics added.)

In *Longbridge's Estate v. Commissioner*, *supra*, cited by the respondent, the trust provided income to each of the grantor's two children, and when the younger child reached 40, or upon the death of the survivor of them before reaching that age, a share of the principal was to go to the child, *if living*, otherwise to others specified. Here, again, the

Court stressed the fact that there was a power with respect to contingent interests.

> "* * * His power under the trust instrument affected not only the time of possession and enjoyment but also the person or persons who might come into ownership and enjoyment of the property. The reservation of power to shift or vary in that manner the interests of the beneficiaries was a substantial attribute of ownership and control. And a donor who keeps within the range of his power such sweeping hold over the possession and enjoyment of trust property has not divested himself of the degree of control required by the statute in order to avoid liability for estate tax. Commissioner v. Holmes, 326 U. S. 480, 66 S. Ct. 257, 90 L. Ed. 228." (Italics added.)

Hauptfuhrer's Estate v. *Commissioner*, *supra*, cited by the respondent, and referred to above, also involved expressly conditional interests.

6. In the *Holmes* case, this Court said that "More therefore is involved than the mere acceleration of the time of enjoyment. The very right of enjoyment is affected, . . ."

As pointed out in detail on pages 11 and 12 of the petitioners' brief, the Tax Court and the Courts of Appeal for the First, Second, Third, Fifth and Tenth Circuits understood this Court to mean in the *Holmes* case, that Section 811(d) is applicable only to powers to shift interests between conditional beneficiaries.

Industrial Trust Co. v. *Commissioner*, 165 F. (2d) 142 (C. C. A. 1);
Commissioner v. *Hoffheimer's Estate*, 149 F. (2d) 733 (C. C. A. 2);
Hauptfuhrer's Estate v. *Commissioner*, 126 F. (2d) 548 (C. C. A. 3);
Zirjacks v. *Scofield*, 197 F. (2d) 688 (C. C. A. 5);

Kings' Estate v. Commissioner, 181 F. (2d) 169 (C. C. A. 5);
Estate of Frank Clowe, 17 T. C. 1467.

In the only cases involving unconditional interests, other than the instant case, it has been decided that the rule in the *Holmes* case is not applicable.

Kings' Estate v. Commissioner, supra;
Barney v. Kyle, U. S. District Court, 4th Div., Minn., decided July 21, 1952.

In the latter case, the deed of trust provided for discretionary payments of income to the daughter of the settlor until the latter's death, at which time the principal and accumulated income were to be paid over to the daughter. The trustees, one of whom was the settlor, had the power to "use such amounts out of the principal from time to time as in their judgment and discretion they may deem necessary and advisable for the care, comfort, support and maintenance of said Mary B. Struthers." It should be noted that the trustees could apply principal to the use of the beneficiary, whereas in the instant case the absence of such a power to apply would require any distributions to be made to the guardians of the infant beneficiaries.

The opinion in this case would serve as an excellent brief for the position of the petitioners. Pertinent excerpts from the Court's opinion are as follows:

"• • • The mere control of the time when the beneficiary, or those whom the beneficiary designates, may enjoy the fund does not constitute the substantial control over the property contemplated by the statute which should subject the decedent's estate to the tax in question.

• • •

The power to terminate the trust as disclosed therein merely clothed the trustees with the right to determine the time of enjoyment by the beneficiary. In

other words, the power to terminate could not be exercised so as to effect a change as distinguished from the time of the enjoyment by those who had a vested equitable interest therein. That vested interest existed without any right of the trustor to change or modify it. . . . The enjoyment of this trust was irrevocably vested in the named beneficiary, or upon his death, if that occurred prior to the trustor's, in his heirs. No control vested in the trustor to alter, amend, revoke, or terminate such enjoyment. . . ."

. . .

". . . There may be language in the Holmes decision which seems to give support to the Government's rather tenuous position in this regard. But such language should be construed in light of the particular facts which are clearly distinguishable from the facts disclosed in the present controversy. The pertinent statutes do not justify a strained and wholly unreasonable construction of the undisputed facts herein in light of the applicable Illinois law. Moreover, it is cogently urged that the trustor could make any choice between the named beneficiary and the beneficiary's heirs when the latter are still carried within the beneficiary during his lifetime. Moreover, any such attempted choice could be thwarted at any time by the beneficiary's last will and testament.

". . . As stated, the trustor in the Holmes case reserved the right during his lifetime to terminate all the trusts and to distribute the principal with the accumulated income to the beneficiary then entitled to receive it. By accomplishing the purpose of terminating the trust, the control of the enjoyment of the trust income and fund and its disposition among the parties designated by the trustor was retained. The Supreme Court construed, therefore, that the right of the trustor to terminate the trust and distribute the principal, or to delay the payment of any income or the corpus to any of the named beneficiaries provided the trustor with the power to determine *which person or persons named by the*

trustor should have the enjoyment of the estate. * * * In the Holmes case, therefore, it was the trustor who designated the contingent beneficiaries and retained the power to make certain that the named beneficiary would receive the trust fund rather than the designated contingent beneficiaries, and it was concluded that this power affected not only the time of enjoyment but also the person or persons who might enjoy the benefits of the trust. * * * Here, we have no contingent benefits which may be defeated by the acts of the trustees. Here, if the trustees accumulated the income and did not choose to pay it over to the named beneficiary, nevertheless upon the death of the beneficiary, the entire trust interest would pass to his estate, and out of which his creditors would be able to obtain satisfaction. While the trust fund would be immune from the claims of creditors during the life of the beneficiary, upon his death the immunities of the trust indenture in that regard would not apply. Consequently, the beneficiary during his lifetime would enjoy the benefits of the fund and the credit standing it would afford him even though the fund was not paid to him until the termination of the trust or to his estate upon his death. *There was no way, therefore, contingently considered, that the trustees could deprive the named beneficiary from enjoying the benefits of the estate.* He could either enjoy the income or fund during the existence of the trust, and upon termination of the trust, the entire corpus, or if he died before the termination of the trust, his named devisees and his creditors would enjoy the benefits thereof. It is the beneficiary, therefore, and not the trustees, who had the power to determine who should enjoy the equitable interest which was donated by the trustor."

II

Under the law of New York, it is absolutely clear that the income and principal interests of the beneficiaries were indefeasibly vested.

1. The question of property rights in New York trusts is solely a question of New York law; and the law as established in New York is controlling.

Helvering v. *Stuart*, 317 U. S. 154;
Blair v. *Commissioner*, 300 U. S. 5.

What the law may be in other jurisdictions, or what it ought to be in New York, is irrelevant.

2. The question of whether or not a future interest is vested is controlled by statute in New York, namely, Section 40 of the Real Property Law, which provides as follows:

> "Sec. 40. *When future estates are vested; when contingent.*—A future estate is either vested or contingent. It is vested, where there is a person in being, who would have an immediate right to the possession of the property, on the determination of all the intermediate or precedent estates. It is contingent while the persons to whom or the event on which it is limited to take effect remains uncertain."

And, Section 11 of the Personal Property Law of New York provides that the rules prescribed in relation to future interests in real property shall be applicable to personal property.

The statutory provision, now appearing as Section 40 of the Real Property Law, was placed in the New York statutes in 1830 as Section 13 of the Revised Statutes. This section and related provisions were enacted to avoid the uncertainties in which the subject was involved. It altered substantially the common law distinction between vested and contingent remainders in favor of a vested interpretation. It created an unwillingness by the Courts of New

York to hold an estate subject to divestment by implying a condition of survivorship which was not expressed.

Moore v. *Littel*, 41 N. Y. 66;
Hennessy v. *Patterson*, 85 N. Y. 91;
Matter of Bowers, 195 App. Div. 548; affirmed 231 N. Y. 613;
Matter of Elting, 268 App. Div. 74, affirmed 294 N. Y. 941;
Herzog v. *Simpson*, 154 N. Y. 496.

In the leading case of *Moore* v. *Littel* (1869), *supra*, Judge Woodruff, speaking for the Court of Appeals said:

> "I deny the right to interpolate qualifications drawn from the refined reasoning of cases or text-books, prior to the statute, to limit the operation of its plain terms."

3. The statutory provisions in New York have been considered and applied by the New York courts in a great many cases over the years and the interpretative principles hereinafter outlined have been well established.

(a) In the absence of a clear intent to the contrary, an estate will be construed as vested rather than contingent. It is the well settled rule in New York that the law favors the vesting of estates, and "unless a contrary intention is unequivocally expressed in the creating instrument, such intention will not be imputed."

Allen v. *White*, 116 N. Y. S. (2d) 223;
Bolton's Will, 257 App. Div. 760, affirmed 282 N. Y. 728;
Matter of Watson's Will, 262 N. Y. 284;
In Re Cramer's Estate, 47 N. Y. S. (2d) 826;
In Re Lurrie's Will, 60 N. Y. S. (2d) 155.

(b) A complete showing of indefeasible vesting of remainders is deemed to exist where, as here, (1) a specific or segregated fund is provided for (2) a named beneficiary

(rather than a class) (3) who is also the income or primary beneficiary (4) with no words of survivorship or provision for alternative takers in the event of the death of the beneficiary. In fact, some but less than all of the foregoing factors have been held sufficient to constitute vesting in a long line of cases, of which the following are but a few:

Matter of Staats, 272 App. Div. 139, affirmed 297 N. Y. 648;
Cammann v. *Bailey*, 210 N. Y. 19;
Matter of Schmitt, 137 App. Div. 286;
Montgomery's Estate, 258 App. Div. 64, affirmed 282 N. Y. 713.

(c) The respondent suggests the application of the so-called "divide and pay over" rule (Br. 10, 38). This rule, if it has any remaining vitality, which is doubtful, is an expedient of last resort which is subordinated to all other rules of construction. In any event, it could have no possible application, except to confirm the contingent character of the gift in those cases where the words of futurity themselves contain the only provision for the gift. The respondent itself (Br. 38) states the rule as follows: "Where the only words of gift are found in the direction to divide or pay at a future time the gift is future, not immediate; contingent and not vested." The rule has no place whatsoever in any case involving a provision of a specific fund for a named beneficiary who is also the primary beneficiary, and where no survivorship condition or alternative takers are provided.

In Re Montgomery's Estate, 258 App. Div. 64, affirmed 282 N. Y. 713;
In Re Fedder's Trust, 61 N. Y. S. (2d) 335 (inter vivos trust);
Fulton Trust Co. v. *Phillips*, 218 N. Y. 573.

The lack of significance of the "divide and pay over" doctrine, upon which the respondent seems to place so much

reliance, is outlined as follows in Section 260 of the *Restatement on Property*.

> "Sec. 260. *Direction to Divide and Pay Over at a Future Date.*
>
> "In a limitation purporting to create a remainder or an executory interest, the fact that the only word of gift to the intended taker thereof consists of a direction to divide and pay over, or to convert, divide and pay over, at the end of the created prior interests or at some other future date is not a material factor in determining the existence of a requirement of survival to the date of distribution.
>
> * * *
>
> "*Comment:*
>
> "a. Rationale. This Section denies the validity and significance of the so-called 'divide and pay over' rule. Wherever this 'divide and pay over' rule has been asserted to exert constructional force in favor of the existence of a condition precedent of survival, two exceptions to the rule have been also recognized and one or both of these exceptions always applies to any situation which is within the rule itself. The first of these exceptions states that the rule has no significance if the postponement of the division and payment is for the purpose of letting in an intermediate interest. * * *"

(d) There is a long and unbroken line of New York cases in which vesting has been found on the basis of the same dispositive pattern as in the instant case, that is, payment of principal to income beneficiary upon attainment of a specified age.

Matter of Staats, supra.

Income of a trust of $5,000 made payable to grandson "until he shall arrive at the age of thirty years and then said fund, principal and accumulated interest be paid to him." No gift-over was provided in the event of the death of the grandson before the age of thirty. The grandson died intestate at the age of twenty-eight.

Held that the principal of the trust "absolutely vested" in the grandson upon the creation of the trust, and was a part of his estate. The decision was based primarily upon the facts that a specific segregated fund was provided—for a named beneficiary, rather than a class—and the remainderman was the income beneficiary.

Commons v. *Bailey*, 210 N. Y. 19.

Residuary trust for wife for life; at her death to be divided, *per stirpes*, into trusts for children of the decedent; "upon the attaining of the age of thirty years by either of my sons the principal of the share until that time held for such son shall after the death of my wife be paid over, transferred or conveyed to him." No contingent remainder-over was provided in the event of the death of a son after the testator's death. A son died at the age of twenty-three before the death of the wife of the testator.

Held, that the principal of the trust was indefeasibly vested in the son upon the death of the testator, and was a part of the deceased son's estate—even though the enjoyment of income and principal was deferred until the death of the testator's wife.

Fulton Trust Company v. *Phillips*, 218 N. Y. 573.

In this case, the Will provided:

> "*First.* To pay over to said Elizabeth Newton the net annual income of the share so set apart for her benefit, for and during the term of her natural life and from and after her decease to her children in equal shares until they shall respectively attain the age of twenty-one years, and as each of such children shall reach that age to pay over to him or her an equal proportionate part of the principal of said share and of the net accrued income thereof. * * *"

The Court of Appeals said:

> "In the case now under consideration, we think that the intention of the testatrix is clear, that the

gift of the residuary estate is absolute and only the time of payment is postponed. Futurity is not annexed to the substance of the gift."

To the same effect are *Matter of Talbot*, 126 Misc. 80, in which the principal was to be paid to the beneficiary at age 40, and *Zartman v. Dittmars*, 87 App. Div. 173, where it was to be paid to the beneficiary at age 30.

(c) The words "when", "then", "from and after", etc., relate merely to the time of possession and not to the time of vesting.

Herzog v. Simpson, 154 N. Y. 493;
Connelly v. O'Brien, 166 N. Y. 406, in which the Court said:

"A remainder is not to be considered as contingent in any case where it may fairly be construed to be vested, since the law favors the vesting of estates. The adverbs of time, therefore, such as *when, then, after, from* and *after*, etc., in a devise of a remainder limited upon a life estate, are construed to relate merely to the time of the enjoyment of the estate and not to the time of its vesting in interest. * * *"

4. In the light of standards prevailing in other jurisdictions, the actual conclusions and decisions reached by the New York Courts reflect an extremely strong judicial inclination towards vesting. In fact, the New York Courts, in finding vested interests, frequently subordinate express conditional provisions to the contrary, or ascribe to an adverb a different time reference than would appear to be warranted by the literal meaning thereof, or in some other manner that obviously runs counter to the views and practices prevailing in other states. Undoubtedly, a circumstance which has played an important part in engendering the extreme inclination toward vesting is the stringent "two lives in being" New York rule against the suspension of alienation, and the desire of the courts to obviate the unfortunate consequences in many cases of an inadvertent violation of said rule. The following cases are a few ex-

amples of how far the courts of New York go in seeking and finding indefeasibly vested interests:

Manufacturers Trust Company v. Chase National Bank, 171 Misc. 49, affirmed 258 App. Div. 787, affirmed 282 N. Y. 790.

In this case the income of a part of an inter vivos trust was to be applied to the use of the grantor's niece "until she should attain the age of 25 years, at which event she shall thereupon become entitled absolutely to said equal part." The niece died after the death of the grantor and before attaining age 25. The Court of Appeals of the State of New York affirmed the decision of the Supreme Court that the niece's estate was entitled to the corpus. In spite of the apparently conditional phrase "in which event," an intention to vest an indefeasible remainder was found. This case illustrates how far the New York courts go in finding an implied gift of an absolutely vested remainder, rather than a reverter, where the possession of the corpus is deferred—much further than the facts in the instant case call for.

Connelly v. O'Brien, 166 N. Y. 406.

The Will provided that the income of the residuary estate was to go to the wife for life, and then the principal was to be paid "to such of my children as may then be alive, share and share alike." A daughter of the testator died before the wife.

It was held that the daughter's remainder vested indefeasibly upon the death of the testator. The Court of Appeals outlined the applicable judicial rule in New York as follows:

> "There could be little doubt with respect to the meaning of this will but for the use of the word then in the last line. The construction to be given to the instrument does not depend, however, upon grammatical rules or any close analysis of the

language employed, but upon settled principles applicable to all wills. A remainder is not to be considered as contingent in any case where it may fairly be construed to be vested, since the law favors the vesting of estates. The adverbs of time, therefore, such as *when, then, after, from* and *at* etc. in a devise of a remainder limited upon a life estate, are construed to relate merely to the time of the enjoyment of the estate and not to the time of its vesting in interest. * * *"

See also *Allen* v. *White*, 116 N. Y. S. (2d) 223, involving facts similar to those in *Connelly* v. *O'Brien*, *supra*.

III

There is no distinction in New York between inter vivos and testamentary trusts, in determining the character of future interests.

In its brief in the Court below (p. 34), the respondent admitted that, if the instant trusts were testamentary, the remainders would be indefeasibly vested under the New York decisions, but contended that the result is, or should be, different where a living trust is involved. In its brief in this Court, the respondent argues along the same lines.

As pointed out above, on page 13, Section 40 of the *Real Property Law of New York*, which controls the construction of future interests, had its origin in Section 13 of the Revised Statutes of 1830. One of the principal purposes of the New York Revised Statutes of 1830 was to abolish any distinctions between future estates based solely on whether they were created by deed or by will. The Notes of the Original Revisers of the Revised Statutes (Note to 1 R. S. 722, sec. 7) state that their object was "to abolish all technical rules and distinctions, having no relation to the essential nature of property * * * and to

reduce all expectant estates substantially to the same class, and apply to them the same rules whether created by deed or devise."*

Accordingly when the New York courts were presented with the question of implying a survivorship condition in connection with an inter vivos trust they refused to do so. *Matter of Seeley*, 195 App. Div. 548, aff'd 231 N. Y. 613 (1921), *supra*. That case resulted in the application of the same rule against implied survivorships as exists with respect to testamentary trusts. The settlor, by deed *inter vivos*, established a trust of personal property, giving a life estate and a general testamentary power of appointment over the corpus to his daughter Mary. In default of appointment, the corpus was given to the settlor's children, Marion and William, in equal shares, "the issue of either then deceased taking its parent's share by representation, and if one be then deceased leaving no issue the survivor to take the whole, and if both be then deceased, only one leaving issue, such issue to take the whole".

The contest was between the executors of the settlor's estate and the Comptroller of the State of New York involving the taxability of the trust under Section 220 of the New York Inheritance Transfer Tax Law, a provision substantially similar to Section 811(d). The State of New York contended that there was a possibility of reversion. The court held that the issue had a vested interest and that the grantor had given up everything. In doing so, the court said:

> "In my opinion, there is nothing in this deed that tends to qualify or cut down the absolute character of the gift."

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* Appendix III, p. 1378 of Fowler's *The Real Property Law of the State of New York* (3d Ed., 1909). Fowler's comment, op. cit. at p. 52 was "The revisers intended to bring the rules relative to limitations of estates into harmony. * * * they made the new rules about future estates apply to both wills and grants alike. These were immense and comprehensive changes, and fertile of great results in modern law."

Manufacturers Trust Company v. Chase National Bank, supra.

In this case, discussed above at page 18, the trustee was to pay a share of the income to the settlor "until she shall" [illegible] the death of the settlor, the trustee was to pay over the principal to the settlor's daughter. The settlor died [illegible] fact that the trustee [illegible] with the decision [illegible] with the decision [illegible] briefs on the [illegible] inter vivos trust [illegible] spondent points out (Br. 23) the court stated that it was not nothing more in the trust deed than the conditional clause above referred to, the settlor's remainder would have been contingent upon her attaining the age of 21 years. The Court, obviously, had considerable difficulty in overcoming the force of said conditional phrase, but, with the usual abhorrence in New York of a failure of a trust and of a reversion to the settlor, the court sought to find a negation of the expressly conditional words in the grant that she attains the age of 21 years. In the last part the trust deed provided a gift-over in the event of the death of the settlor during the lifetime of the settlor, and from that a presumed intent by the settlor to reserve nothing to herself under the circumstances that transpired and for which no provision was made. If inter vivos trusts were not so susceptible of a finding of vesting as testamentary trusts, then, surely, this was a case in which a failure of the trust should have been found.

In Re Fedder's Trust, 61 N. Y. S. (2d) 385.

Income to the settlor for life, then income to his daughter for life; upon her death, the trustees "shall pay over

[redacted]

[redacted]

[redacted]

The following expression from the court's opinion in the recent case *of Allen v. Trust Co.*, 116 N. Y. S. (2d) 228, again confirms the fact that, in construing instruments for the purpose of ascertaining whether remainders are vested or not, the New York courts recognize no distinction between inter vivos and testamentary trusts:

> "From the extensive judicial expression on the subject of future vesting, immutable, certain basic and fundamental canons of construction have evolved which serve as unerring guideposts for use in the penetration and determination of the intention of a testator or a settlor, which, of course, is the paramount and controlling factor to be sought. The law favors as a matter of policy the early vesting of future estates. Unless there is a contrary intention unequivocally expressed in *the creating instrument*, the postponement of the vesting will not be imputed. Matter of Bolton's Will, 257 App. Div. 760, 15 N. Y. S. 2d 696, * * *." (Italics supplied.)

In this connection, it should not be overlooked that the principal purpose of the original enactment of the statutory provision, which is now Section 40 *of the Real Property Law of New York*, was to abolish any differentiation between inter vivos and testamentary trusts, in so far as the construction *of future estates* is concerned.

While the New York law is controlling in determining the nature of property rights under a trust, for Federal tax purposes, it is noteworthy that it is also the prevailing rule in other jurisdictions that the considerations in applying gifts in testamentary instruments are equally applicable to *inter vivos* dispositions. *Brock v. Hall*, 33 Cal. (2d) 885. In 11 A. L. R. 2d 683 (annotations to *Brock v. Hall*) this matter is summed up as follows, with many citations:

> "The generally prevailing doctrine accords with the view expressed by the majority opinion in *Brock v. Hall* (1949), 33 Cal. 2d 885, 206 P. 2d 360, 11 A. L. R. 2d 672, that inasmuch as 'the primary duty of

the court in construing all documents is to give effect to the intention of the maker; that is, no justification for any distinction in this regard between instruments creating legal estates and those taking effect at death exists; the intention to be gathered from the words of a conveyance, whether they be contained in a declaration of trust or a will, would ordinarily be the same. Accordingly, 'implied gifts may be found in both wills and later vested transfers in trust.' " (p. [illegible])

In that connection, the following observation is made in said annotation, at page 467, with respect to *Chater* v. *Carter*, 283 U. S. 219, cited by the respondent (Br. 8, 27), and hereinafter discussed:

"... Many of the authorities dealing with cross remainders in deeds, rest support as is given to the proposition that a gift by implication cannot arise from an estate vested by instrument executed chiefly of indefinite expressions used by the Federal Supreme Court in one case, the somewhat similar language found in the opinion of the Hawaii Supreme Court in the same case, and the statements of doctrine contained in the dissenting opinion in *Brock* v. *Hall* (1940) 15 Cal. 2d 500, 102 P. 2d 760, 11 A. L. R. 2d 674."

In those sections of the Restatement of Property (1936) dealing with the many facets of the construction of trusts, there are repeated and interchangeable references to "wills" and "deeds", some of which are the following: Sections 115, comment (c); 257, comment (c); 258, comment (c). Furthermore, in the introductory note to topic 3, preceding all of the sections with respect to limitations of remainders or executory interests, it is clearly indicated that all of them deal with deeds as well as wills. Volume 3 of Restatement of Property (p. 1245).

The rules of construction set forth in Section 257 of the Restatement of Property, applicable alike to wills and deeds, are of special interest in this case, as they deal, among other things, with future interests of the kind in-

volved in this case, that is to say, trusts involving remainders where possession is deferred to a specified age. Very pertinent excerpts therefrom are the following from comment (d):

> "d. *Situations commonly within the stated rule.* When a remainder or an executory interest is limited to a person presently identified (see Sect. 356, Comment a, as to the types of limitations effective for this purpose) with an added phrase 'payable when he becomes 21,' or 'to be had by him at 21,' or 'to be turned over to him when (the youngest of a designated group) attains 21,' or with some other phrase of similar import, the limitation is within the rule stated in this Section. * * *
>
> * * * An application of the rule stated in this Section to such limitations as are described in the first paragraph of this Comment, by eliminating the condition precedent of survival, normally leaves the created interest free from all requirements of survival and hence, if it is a remainder, *indefeasibly vested.*" (Italics added.)

In fact, in the only cases other than the instant case involving Section 811(d), in which the taxpayer contended that said section does not apply where vested interests are involved, the Courts held that the interests were vested.

Hays' Estate v. Commissioner, 181 Fed. (2d) 169 (in which the Court noted that, under Mississippi law, the remainders would have been vested without the words of heirship in the creating instrument).

In *Barney v. Kelm*, *supra*, discussed above at page 10, a deed of trust involving facts similar to those in the instant case, was held to have created a vested remainder in the beneficiary, under Minnesota law.

See also 1 *Scott Trusts*, Sec. 142.1, page 715, and annotations in 112 A. L. R. 581, 585.

The equality of the treatment of inter vivos and testamentary trusts is sometimes stated to be based upon the

presumption that all such grants are taken most strongly against the grantor.

Restatement of Law of Property, 1 Appendix page 16;
Wood v. Paul, 250 Pa. 503;

Hays' Estate v. Commissioner, *supra*, in which the court said:

"All such grants are taken most strongly against the grantor."

In passing, it should be noted that in *Chater v. Carter*, 283 U. S. 573, cited by respondent (Br. 8, 37) and criticised in the note to 11 A. L. R. 2d 683, referred to above at page 25, the principal of a Hawaiian trust was to be paid to the beneficiary on January 1, 1913 "if she shall then be living." It is obvious that the beneficiary's interest was expressly conditioned upon survivorship and, it is submitted, that premature death of the beneficiary would result in a failure of the trust, whether it was inter vivos or testamentary.

That the prevailing rule is one of vesting under facts such as those in the instant case is shown not only in Section 257d of the Restatement of the Law of Property, hereinabove referred to on page 26, but is set forth with even greater particularity in Section 128c of the *Restatement of the Law of Trusts*, as follows:

"c. *Where principal is to be conveyed to beneficiaries in trustee's discretion.* Where property is transferred in trust to pay the income to a designated person and to convey the principal to him whenever the trustee in his discretion deems it wise to do so, it is a question of interpretation whether the designated person is given the whole beneficial interest, or only an interest in the income and an interest in the principal contingent on the exercise by the trustee of the power to convey the principal to him during his lifetime. *If there is no gift over of the principal,*

the inference is that the beneficiary has the whole beneficial interest, and if he dies before the trustee transfers the property to him, the trustee can be compelled to transfer it on his death to his estate." (Italics supplied.)

IV

There is additional support in the trust instruments for the application of the New York law favoring vesting.

It is the main burden of Point II of the respondent's brief that the usual rules of construction in New York do not apply to inter vivos trusts. As hereinabove pointed out, there is no basis for any such distinction in the New York cases and, in fact, the New York Courts have gone to the same lengths in discerning vested interests in both types of trusts under the basic rule in New York that the vesting of future interests is to be favored.

As shown in the petitioner's brief, the case at bar is a strong case for the application of the well established New York rule favoring vesting, because of the combined elements of a specific and segregated fund, a gift of the income and principal with only the payment deferred, and no words of survivorship or gift-over. However, in addition to the force of these basic elements calling for the application of the generic rule, there are other aspects of the trust instruments that more reasonably reflect an intention of the grantor to give all to the children than an intention to reserve the remainder in the unlikely event of the demise of a child before the grantor.

In the first place, each instrument provides that "I, Morris Lober * * * do hereby sell, assign, transfer and deliver unto myself, as Trustee, for my son * * *." In other words, he states in each instance that he is transferring the assets of the trust for the named child. This is more consistent with the intention that the decedent was completely

disposing of the property for the benefit of the child than an intention to reserve any interest therein.

In the second place, the reservation of the power to accelerate distribution of principal reflects an intention to be even more generous with the child than requiring him to await the attainment of age 25. Perhaps, the decedent had in mind the possible exercise of the power upon the marriage of the child or his establishment of a business. Isn't it unlikely that the defendant intended a reservation to himself—if he thought at all about the possible predecease of the child before the early age of 25—when he expressly placed himself in the position to make earlier disposition to the child.

In the third place, he directed that no part of the income should be used for the maintenance, education and support of the child, and in the second and third trusts, added the explanation, "but that the donor shall continue to discharge his obligations to his minor son (daughter) from his own personal funds." In the absence of this direction, the income would have been subject to application by the grantor for the child's maintenance and education, under the other provisions of the instrument permitting distribution or accumulation of income, thereby relieving the grantor of such expense, and, to that extent, would diminish the accumulation of income available to the child at 21. The only reasonable inference that can be drawn from this is that the grantor wanted to give the child the full measure of the property, unimpaired by any expenditures for his support and education. This provision in the trust instruments, prohibiting the use of income for the infant's support and education, is a variance from the usual trust provisions for children, under which the income may, and ordinarily is intended to, be used for such purposes.

Therefore, it is submitted that, even if the New York rules of construction did not apply generally to inter vivos trusts, which clearly is not the case, the foregoing provisions in the trust instruments, together with the element

making up a strong basic pattern for vesting under the applicable New York rule, furnish a far more reasonable and independent basis for judicial ascertainment of intention to vest than one of reversion.

In conclusion, it is submitted that the respondent's contentions, and the authorities offered in support thereof, do not survive examination. The interests of the beneficiaries in the income and principal of the trusts were indefeasibly vested, and common sense and an unbroken line of tax decisions dictate against an unprecedented extension of the rule in the *Holmes* case to such vested interests.

Respectfully submitted,

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The test applied by this Court was not whether the beneficiaries took vested interests, but whether the grantor could by the exercise of the power affect the enjoyment of the beneficiaries, the term "enjoyment" being used as connoting (p. 486) "present economic benefit rather than technical vesting of title or estates."

Petitioners contend that the *Holmes* case is not controlling here, since in that case the beneficiaries had conditional interests[3] and the power reserved by the grantor was a power to remove a condition upon which the beneficiary's interest was based, whereas in the instant case each beneficiary involved had a vested interest which the decedent could not cut off by the exercise of such power. The court below, however, held that even assuming that under the law of New York each beneficiary had a vested interest,[4] the power reserved by the decedent came within the terms of the statute. In this connection, it stated (R. 31-32):

> But for the practical purpose of determining whether the creator of a trust has retained enough of the incidents of ownership or control to make it probable that Congress intended to tax the trust *res* as a part of his estate, such an identification lacks reality. A father who has

[3] Cf., however, the *Holmes* case (p. 486) where this Court stated that each of the beneficiaries may have been invested with a "fee simple" in an equitable interest, subject to divestment by the contingency of the beneficiary's death during continuance of the trust.

[4] "Vested," was used by the court in the sense that upon his death the right to the principal would have passed to his estate rather than returning to the settlor.